

STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

In the Matter of: Proposed adoption of the Insurance Commissioner's regulations pertaining to pure premium rates for workers' compensation insurance, the Experience Rating Plan, and the Uniform Statistical Reporting Plan to be effective on July 1, 2004.

FILE NUMBER RH 04036694

DECISION

When I took office as Insurance Commissioner in January of 2003, this state was faced with a workers' compensation insurance system that was approaching melt-down. Benefits for injured workers were in the bottom third tier in the United States and employer premiums were the highest in the country. Costs were literally out of control and there had been no meaningful reform in ten years. Workers' compensation had a choke-hold on California's economy, killing job growth and providing a strong incentive for employers to flee the State.

In July of 2003, the Workers' Compensation Insurance Rating Bureau (WCIRB) proposed yet another in a series of increases in pure premium rates -- an increase of 12%. This was in addition to an interim increase of 7.2% that had been approved only a few months before. It should be noted that "pure premium" consists of loss costs -- the actual cost of benefits plus loss adjustment expenses, which include the costs of processing claims. Pure premium does not include other insurer expenses such as overhead, profit, taxes, or commissions.

For these reasons, I made workers' compensation reform my number one priority. Using the full resources of the Department of Insurance, and working very closely with Governor Davis and the Legislature, together we managed to bring about major reform of the underlying cost drivers in the system. AB 227 and SB 228, enacted on September 30, 2003, produced substantial positive changes. These bills together immediately reduced costs in the system by creating one-time savings of over \$5 billion and ongoing savings of \$5.5 billion annually (based on September, 2003 projections).

Finally the days of endless pure premium rate increases were over. Instead of its recommended increase of 12% for January 1, 2004, the WCIRB revised its proposal downward to a decrease of 2.9%. Based on my review, however, I believed that the savings were more significant. Accordingly, based on reform savings and other factors, I promulgated a decrease of 14.9% in the pure premium rates for that same period.

Governor Schwarzenegger and the Legislature followed up on this earlier success with another round of reforms contained in SB 899, which became law on April 19, 2004. I made a request that they clarify ambiguities in both pieces of legislation and they did so. SB 899 is a significant reform of the system and over time will result in substantial savings. For those policies incepting or renewing as of July 1, 2004 and beyond, SB 899 will save 7%. This 7% is in addition to the 14.9% reduction, and produces a combined decrease of 20.9% less than the pure premium rates in effect as of July 1, 2003.¹

At the most recent pure premium rate hearing, based on its continued review of AB 227 and SB 228, and its consideration of SB 899, the WCIRB proposed a combined overall decrease of 17.4 percent from the advisory pure premiums in effect on July 1, 2003. This number reflects an adjustment of its earlier proposal and new savings associated with SB 899. My evaluation indicates that the 14.9% decrease made effective January 2004 should remain in effect and, as noted above, that SB 899 should provide a further decrease of 7% for policies effective July 1, 2004. This produces a combined decrease of 20.9 % as compared to the WCIRB's combined rate decrease of 17.4 % for the same period. The difference is a result of actuarial methodologies between the WCIRB and the Department.

I have not included decreases in pure premium rates due to the changes in the permanent disability system, although they are meaningful reforms. There currently is too much uncertainty concerning the implementation of these complex changes to make a reasonable estimate of the cost savings to be derived from them. The new Administrative Director (AD) of the Division of Workers' Compensation must write regulations to implement a disability schedule that is unique and has never been used in any other jurisdiction before. Furthermore, there is a risk that lawsuits will be brought to challenge these regulations.

Given this uncertainty, it seems inappropriate to include a provision for savings due to changes in permanent disability in the pure premium rates for July 1, 2004. However, we will monitor the Administrative Director's progress carefully. I expect that the AD will be able to implement the disability schedule on time and that it will result in a decrease in the pure premium rates.

I will promulgate advisory pure premiums again in November of this year for policies incepting on January 1, 2005. At that time, if there is evidence to substantiate the probability of savings, I will include them in the advisory pure premium rates. If there are demonstrable savings from the permanent disability changes, I would expect insurers to modify the rates of in-force policies to take those savings into account, to the extent appropriate.

It is important to understand that the Insurance Commissioner does not set workers' compensation rates. Insurance companies are allowed by law to set any adequate rate they desire. However, the 2003 reform legislation includes a provision that requires insurers to file rates that include the savings that I determine are due to the reforms. It was the clear intent of the

¹ Percentage savings of individual elements do not add up to the totals shown because the application of each individual savings element reduces the cost basis to which the subsequent elements are applied.

Legislature that the cost savings enacted in 2003 and 2004 be passed through to policyholders and not accrue to insurers' bottom lines.

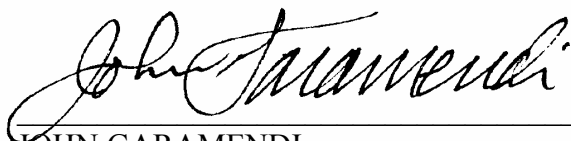
Insurers that adopt the 7% or greater pure premium rate reduction with no additional changes or offsets will be granted an effective date of July 1, 2004, for all filings received prior to that date, and the 30 day waiting period will be waived.

Once again, I must remind those in the workers' compensation community that the reforms enacted by the government are not self-executing. In order to achieve the necessary savings while also ensuring that injured workers are treated fairly, all participants in the system must live up to their responsibilities. Many of the reforms, particularly in regard to permanent disability benefits and medical networks, break completely new ground for workers' compensation in our state and will require thoughtful implementation and, in some cases, extensive training. One thing is certain: the insurers and self-insurers who implement the reforms quickly and efficiently will achieve a substantial competitive advantage over their less diligent competitors.

Government must live up to its responsibilities as well. Once again, legislation to clean up any ambiguities or loopholes in SB 899 must be developed. Perhaps the biggest challenge of all has been given to the Division of Workers' Compensation, which must provide guidance and leadership on numerous important issues. Now that the Division's user funding has been secured, it must ask for and receive the resources it needs to do the job.

I hereby adopt the attached Proposed Decision and Proposed Order of Hearing of Officer Larry C. White as my Decision in the above-entitled matter, amended as noted above.

IT IS SO ORDERED THIS 28th DAY OF MAY, 2004

A handwritten signature in black ink, reading "John Garamendi". The signature is fluid and cursive, with a horizontal line drawn underneath it.

JOHN GARAMENDI
Insurance Commissioner